Nissan SEC Inquiry Highlights Uncertainty for Non-U.S. Issuers of ADRs

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This week, it was reported that Nissan Motor Co., Ltd. ("Nissan") had received an inquiry from the United States Securities and Exchange Commission (the "SEC"), regarding alleged disclosure violations involving payments to its former Chairman, Carlos Ghosn. The reported inquiry is an unusual instance where the SEC has opened an inquiry into possible disclosure violations of a company without securities listed in the United States. Nissan has Level I American Depositary Receipts ("ADRs") traded over-the-counter in the United States, but is not listed there and thus is not subject to U.S. reporting and record keeping requirements.[1]

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The announcement of the inquiry—which does not necessarily indicate that a formal investigation will be launched by the SEC or that regulatory sanctions will result-comes at a time of some uncertainty as to the jurisdictional reach of the U.S. securities laws for non-U.S. issuers who do not have securities listed on a U.S. exchange but have securities traded over-the-counter. A U.S. anti-fraud action brought under Section 10(b) and Rule 10b-5 of the U.S. Securities Exchange Act would be subject to the jurisdictional limitations imposed by the U.S. Supreme Court in *Morrison v. National Australia Bank* (130 S. Ct. 2869) in 2010, which held that Section 10(b) applies only to securities transactions that are (1) listed on a securities exchange in the United States or (2) a domestic [U.S.] transaction in other securities. As Nissan's ADRs are not listed in the United States, a fraud action could only be brought against Nissan under *Morrison* if the alleged fraud involved a "domestic transaction in other securities."

Lower courts have been split on whether or not trading in ADRs satisfies this test, though in *In re: Volkswagen "Clean Diesel' Marketing, Sales Practices, and Products Liability Litigation* (3:15-md-02672, 2017 WL 66281 (N.D. Cal. Jan. 4, 2017)), a court denied a motion to dismiss securities fraud claims filed against Volkswagen by U.S. purchasers of Level I ADRs, finding that Volkswagen's sponsorship of its ADR program

[1] ADR programs are generally categorized into three levels, depending on the extent to which the foreign company has accessed the U.S. markets. "Level I" ADRs—like Nissan's—are not listed on any U.S. exchanges, and instead trade over-the-counter. Level I ADRs have minimal regulatory requirements—issuers are exempt from the U.S. reporting requirements under Rule 12g3-2(b) of the U.S. Securities Exchange Act, as well the accounting books and records and internal control provisions of that Act.

established a sufficient connection to satisfy Morrison's second prong. A decision (*Stoyas v. Toshiba* (896 F.3d 933)) extending the reach of Section 10(b) claims even to unsponsored depositary receipt programs—which are set up by depositaries without the participation or consent of the issuer—is set to be reviewed by the U.S. Supreme Court this year.

While the transactional test of the *Morrison* decision applies, on its face, to all actions brought under Section 10(b) of the Exchange Act, Congress explicitly carved out an exception for the SEC. Section 929P(b) of the Dodd-Frank Wall Street Reform and Consumer Protection Act amends the anti-fraud provisions of the Exchange Act, the U.S. Securities Act and the U.S. Investment Advisers Act to establish the jurisdiction of U.S. federal courts over an action or proceeding brought by the SEC or the U.S. Department of Justice involving (1) conduct within the United States that constitutes significant steps in furtherance of a violation, even if the securities transaction occurs outside the U.S. and involves only non-U.S. investors, or (2) conduct occurring outside of the United States that has a foreseeable substantial effect within the U.S. The SEC has repeatedly asserted that the Dodd-Frank extraterritoriality provision effectively overrules *Morrison* and reinstates, in civil cases brought by either the SEC or Department of Justice, the conduct and effects tests used by courts of appeals prior to *Morrison*. Just last week, the Tenth Circuit, in *SEC v. Scoville, et al*, 2019 WL 302867, *1 (10th Cir., Jan. 24, 2019), concurred with the SEC and became the first Circuit Court to expressly hold that the SEC has authority to enforce the anti-fraud provisions of the federal securities laws extraterritorially where there is sufficient conduct or effect in the United States.[2]

However, even if the SEC or a private litigant can establish jurisdiction, the usual elements for a Rule 10b-5 claim would need to be established, requiring, among other things, that the material misstatement or omission was material to investors and made with "*scienter*" (i.e., with intent or recklessness). Those elements can be difficult to prove, and companies considering setting up or maintaining Level I ADR programs need to balance any potential liability against the benefits to the company and its investors of having an ADR program. The Nissan inquiry shows that in addition to concern about possible private litigation risk, issuers with such programs also need to keep in mind the potential for SEC action in the event of an alleged disclosure violation.

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Please do not hesitate to contact us with any questions.

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[2] For a discussion of *Scoville*, see our Client Alert here: https://www.debevoise.com/insights/publications/2019/01/tenth-circuit-affirms-secs-extraterritorial-reach.

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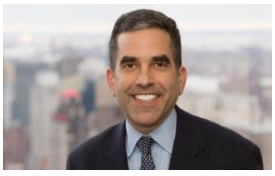

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